

Forest Resources Commission

*Views on the Establishment of Timber
and Log Markets in British Columbia*

July 1992

1. Introduction

- 1.1 Terms of Reference: On September 24, 1991 the Forest Resources Commission was assigned the following task:

"Specifically, what conditions must be met to ensure the effective and efficient functioning of a log market, and can these conditions be met in all parts of the province."

- 1.2 Background: The foregoing task was in response to recommendations previously made by the Commission in The Future of Our Forests (April 1991) in which a recommendation was made to develop a competitive log market in British Columbia. The timber source for these logs was to come from changes in present tenure arrangements, such that about half of the timber supply would flow from lands held directly by the Crown or from tenures ceded from the Crown to various community forests, woodlot operators or Indian Bands. The establishment of a competitive market therefore is predicated on the assumption of some fundamental changes in the present system of tenure. If more competitive markets for logs and timber are to be achieved in B.C., the current tenure system must be changed and direct control of the resource by forest products companies must be severely reduced.

- 1.3 Sources of information: The Commission engaged several consultants to study the implications and specific mechanisms of a competitive market structure.

Specifically, a contract was made with the CCG Consulting Group Limited to review the workings of log and timber markets in other jurisdictions. They were asked to identify those factors in working markets that related to reliable fibre supply, raw material cost, returns to the owner of the resource, and how and why markets became organized the way they did. Dr. David Haley and Jeanette Leitch of the University of British Columbia were hired to examine the

Commission's previous recommendations on timber resource allocation with particular emphasis on value added wood products. A contract was awarded to SRI International to undertake an objective assessment of the value of B.C.'s forest resource and whether or not current policies and practices were consistent with that valuation. The CCG Consulting Group's report contained the most specific material relating to the implementation and operation of a competitive log and timber market and this report was thoroughly critiqued. All of these reports and critiques are published background documents to this report.

In spite of the consultants having eight months to work on this matter, the Commission finds itself unable to make definitive recommendations to government on those "conditions that must be met to ensure the effective and efficient functioning of a log (and timber) market" for British Columbia. The reasons for this are twofold. First, in the opinion of the Commission the performance of two of the consultants, namely SRI International and CCG Consulting Group Limited, in addressing their assigned tasks and doing so in a timely manner was less than satisfactory. However, elements of these consultants' reports, together with the other major background document (Haley and Leitch) and most of the solicited critiques demonstrated factors and applications that might well be adopted in detailing and structuring more competitive log and timber markets in B.C. Second, in no jurisdiction studied does the pattern of forest ownership approximate the 94% public ownership found in British Columbia. Ownership patterns appear to dictate, in large measure, how markets form and operate. Therefore great care must be taken in trying to replicate other markets in British Columbia.

With these stated limitations, the Forest Resources Commission believes, however, that it has learned a number of things about log and timber markets that have direct relevance

to the development of such a market in the Province. The following findings, then, are put forward to advance the discussion of log and timber markets in British Columbia.

- 1.4 Original Recommendations Revisited: After studying how markets were formed and operate in other parts of the world, it became obvious that the Commission's original recommendation regarding the establishment of a competitive log market needed to be recast to specify a market for standing timber as well as a log market.

In all other jurisdictions, fibre supply to the forest products industry has been organized through a combination of using timber either owned or controlled by the company together with short and long-term purchases of timber or logs from a variety of other sources. This wide array of fibre supply arrangements has emerged because it best reflects the needs of buyers and sellers and is, therefore, so arranged as to operate for their mutual benefit. In all jurisdictions, security of supply is a major factor for the forest products industry. It is the Commission's view, therefore, that if a market is to function best for the benefit of both buyers and sellers (including the Crown) the kind of diversity and flexibility represented in the other markets studied should be replicated as much as possible in British Columbia. This would include, but not be limited to, short and long-term timber sales, short and long-term wood supply agreements, and spot sales of logs and trades. Log and timber markets are so fundamentally different in organization and operation that they require separate analysis and subsequent follow-up.

It is also clear that in jurisdictions where competitive markets operate, the majority of wood fibre used by forest product companies comes not from their owned or tenured lands but is sourced through a market. The wood fibre from lands controlled by forest product companies tends to represent a

core or base supply while wood sourced through the variety of market mechanisms is used to match mill capability and to balance fluctuations in the market for end use forest products. This evidence gives support to the Commission's earlier conclusions that a reasonable source of core supply must be left to companies with processing facilities by means of secure, area-based tenures. Equally, it gives support to the contention that for a more competitive fibre market to work in British Columbia, a significant amount of the wood now allocated under tenure must be released to flow through a market. Finally, it verifies the Commission's conclusion that both the Crown and tenure holders without processing facilities must be involved in providing a source of fibre supply to the market.

It is apparent that the creation of a truly competitive, open market could have profound social implications on employment and community stability in achieving maximum economic efficiency. It is also recognized that no other jurisdiction has attempted to create a competitive market operating under the constraint of ownership that parallels the Crown provincial. In fact, the combination of improving economic efficiency without unduly undermining the social fabric, coupled with essentially one owner of the resource and few buyers and sellers demands compromises to a "perfect" market to obtain both private gain and public benefit. This adds layers of complexity to the establishment of such a market so that continued public debate on markets and complementary tenure structures is both inevitable and desirable.

- 1.5 Why a Market?: The Commission has previously recommended a market for several reasons. The resource has significant value and over the full economic cycle, a more competitive market system would tend to reflect the fair market return to the sellers for timber extraction. This is not to say that in

stringent economies, such as exist presently, the return on the resource might not fall. Competitive markets should lead to improved economic efficiencies. More efficient companies would eventually grow and control more wood at the expense of the inefficient, and at least some of these companies would produce an array of more sophisticated wood products, which would command a higher value on world markets. Some companies should be expected to pay higher prices for certain grades of timber and logs. It is essential that the Crown in fact obtain and be perceived to obtain a fair and appropriate price for its timber if for no other reason than to help offset the significant increase in silviculture expenditures estimated as a consequence of enhanced resource stewardship.

Another reason for initiating an enlarged market for timber and logs is to provide raw material access to those companies and individuals prepared to meet competitive market prices in anticipation of generating profits through production of niche or special higher-value products. In this respect, it should be noted that the present log market can be difficult to enter and exit and information is lacking on the value or selling price of logs that are traded or purchased. These deficiencies will have to be addressed.

Finally, if competitive market pricing could replace administrative pricing, the British Columbia government and industry would be relieved of the constant debate surrounding stumpage prices. There must therefore be a close correlation between economic rent and the value of marketplace sales. Setting stumpage as a percentage of marketplace sales would be one way to accomplish this.

2.0 Market Operations

- 2.1 Log Markets: In British Columbia, markets for logs have developed on both the coast and in the interior. They have been created by the forest products industry primarily to ensure the appropriate match of wood to the characteristics of

a particular mill and to add to wood supply not available from the company's own tenure(s). Elements of the log market include spot sales, wood supply agreements and trades. The market for logs has developed as an essentially private enterprise activity with virtually no government controls or involvement. In these respects, British Columbia's log markets closely approximate log markets in other jurisdictions and given that they are working to advantage of both buyer and seller there seems to be no reason to suggest change, rather, they should simply be allowed to continue to evolve as a significant form of market.

There is, however, one major difference in British Columbia when compared to log markets in other jurisdictions. That is the number of sellers and the amount of wood actually traded by means of a log market. In all other jurisdictions examined, there were a significant number of private owners of timber that supplied wood to the log market. That does not exist in British Columbia due to the fact that the Crown owns 94% of the forest land base and has chosen to allocate the rights to harvest timber almost exclusively to companies with processing facilities. Thus, under current conditions, the scope and size of a log market is severely restricted. This could be rectified to a significant degree if, in realigning the tenure structure in the province, a significant proportion were allocated to tenures not directly associated with processing facilities such as woodlots, community forests etc. as recommended in The Future of Our Forests.

- 2.2 Timber Markets: In most other jurisdictions studied, a significant portion of market wood came from the sales of standing timber. Some timber sales were made from private land but most came from government land. In British Columbia the only competitive timber sales come from the Small Business Forest Enterprise Program which comprises up to 15% of the Allowable Annual Cut (AAC).

As previously mentioned, British Columbia some time ago decided to allocate virtually all of its Crown timber to forest product companies with processing facilities by way of assigned tenures. Prior to that, a substantial competitive timber market did exist in the province. This decision to allocate Crown land by way of tenures virtually removed any competitive access to Crown timber. A return to more competitive access to timber and market based pricing will require the re-establishment of a timber market in B.C. Again, this will require tenure reform as the province must regain direct control of a significant portion of Crown forest now allocated by way of tenure to companies with processing facilities. In re-establishing a timber market, issues to be addressed are timber supply, timber demand and market operation.

Among the supply issues addressed in the appended reports are: method of offer (sealed and/or oral bidding); appraisal and upset pricing; size of sale; frequency of offerings; method of payment; and permissible time for harvest of sale. A variety of opinions are offered, with the general recommendation that a gradual introduction and a flexible system be maintained. Some annual cut controls would seem necessary to provide assurance that financial obligations of loggers, mill owners and their employees could be met. Controls could be set in concert with controls on area-based tenures held by companies with processing facilities, so that the quantity of market timber available could be made consistent with demand. Application of cut controls to only area-based tenure of companies may be sufficient to ensure industrial and social stability. However, cut controls may lead to more volatile timber prices by causing fluctuations with demand that would be more extreme than under "pure" market forces.

Pricing is a critical element in timber sales. An appraised or upset price is generally recommended above which

bids are accepted. The stumpage paid competitively should prove the major indicator or determinant for the other half of the timber supply held by companies in long-term area-based tenures. Thus it is equally critical for the timber market as well as the log market to report transaction prices publicly. This feedback loop for pricing stumpage on long-term tenures is necessary to avoid collusion or surrogate over or under bidding among large companies with marginal timber requirements, and to alleviate the advantage that might otherwise be held by companies who have non-competitive stumpage.

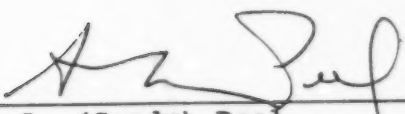
3.0 Concluding Remarks

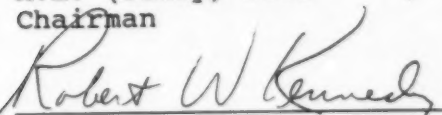
3.1 Recommendations

The Forest Resources Commission recommends that:

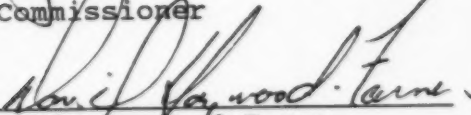
1. The government encourage the development of a log market and a timber market which are more active, competitive, open and transparent; and through which at least 1/2 of the harvestable timber would flow.
2. All transactions on these two markets should be accurately recorded and the information used to establish stumpage on tenured wood.
3. The development of a log market and a timber market should be accomplished with the full co-operation and involvement of all of the participants - buyers and sellers (including the government). In fact, they should be the ones to establish the market and its rules of trading, etc. and to run the day-to-day operations of the market. If a market is to work, it must serve the needs of its participants.
4. The government revise tenures so as to expand timber sales from Crown land under its administration as part of a broader market strategy and to ensure that the public interest is protected in the workings of an overall market.

3.2 Future Directions: The background documents and the people consulted in the private and public sectors during their preparation could form the basis for useful workshops or seminars to explore further the specific mechanisms for competitive pricing and markets. Because of the inter-relationship between markets and tenure, workshops might usefully be conducted prior to or in conjunction with tenure considerations, because the notion and extent of timber markets would influence the direction of change in tenure policy. Alternatively, changes to the tenure system could be considered first, keeping in mind the possible introduction of a market system as a constraint on any new tenure arrangement.

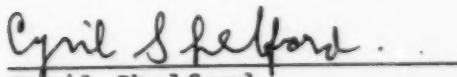

A.L. (Sandy) Peel
Chairman

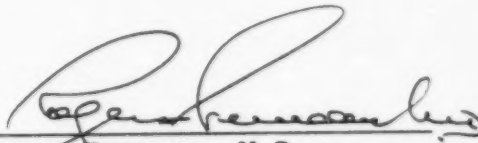

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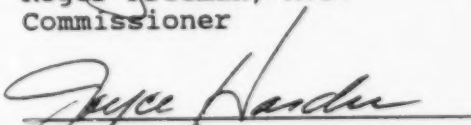

Phil Hallinan
Commissioner

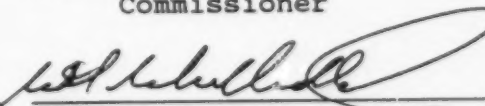

David Haywood-Farmer
Commissioner

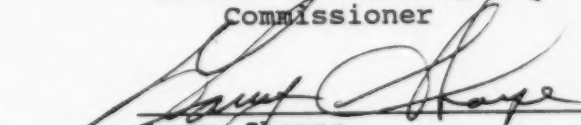

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